BANK OF CANADA
BANQUE DU CANADA

Business Outlook Survey

Results of the Winter 2015–16 Survey | Vol. 12.4 | 11 January 2016

Overall, responses to the winter Business Outlook Survey *indicate that business sentiment has deteriorated as the negative effects of the commodity price shock continue to unfold and spread beyond the resource sector. However, exporters not directly affected by lower commodity prices continue to benefit from strong U.S. demand and the weak Canadian dollar.*

Overview

- While firms continue to anticipate an acceleration in their sales over the next 12 months, the diverging outlook evident in recent surveys persists. The low-commodity-price environment poses significant challenges for many businesses, since the adverse effects of the shock are increasingly being felt across most regions and sectors. Expectations for future sales are more robust among exporters in light of strengthening foreign demand.
- Investment and hiring intentions have fallen to their lowest levels since 2009 as domestically oriented firms and those exposed to the resource sector adjust their plans to slower activity. Yet, in response to stronger foreign demand, exporters not tied to commodities plan to increase their investment, supported by the boost to competitiveness from the depreciation of the Canadian dollar.
- Capacity pressures are still subdued, largely owing to weak demand conditions, especially for firms in the Prairies. Excess capacity remains more prevalent among domestically oriented firms than among exporters. Firms continue to report that labour shortages are less intense than they were a year ago.
- Businesses expect input and output prices to rise at a slower pace, in part reflecting dissipating upward pressure anticipated by firms at the time of the survey from the depreciation of the Canadian dollar, as well as weak market conditions. Inflation expectations fell, with a greater share of firms expecting inflation to be in the lower half of the Bank's inflation-control range.
- Overall, firms reported little change in credit conditions. While tighter credit conditions continue to be linked to the commodity sector, reports of easier conditions were more widespread than in the autumn survey.

Business Activity

On balance, firms reported no change in their past sales growth (**Chart 1**), since weaker sales growth in the Prairies was offset by somewhat stronger growth in other regions. The balance of opinion on future sales remains positive and is unchanged from the autumn survey, indicating that, on average, firms expect a modest improvement in sales activity over the next 12 months (**Chart 2**). However, the persistent drop in

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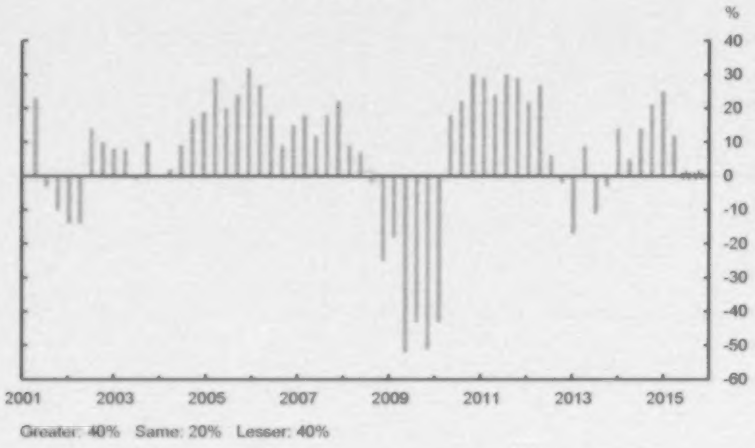
The *Business Outlook Survey* summarizes interviews conducted by the Bank's regional offices with the senior management of about 100 firms selected in accordance with the composition of the gross domestic product of Canada's business sector. The winter 2015–16 survey was conducted from 12 November to 8 December 2015. The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding. Additional information on the survey and its content is available on the Bank of Canada's website. The survey results summarize opinions expressed by the respondents and do not necessarily reflect the views of the Bank of Canada.

commodity prices has depressed business sentiment among respondents. Most notably, the outlook for sales deteriorated in the Prairies, where several firms directly tied to the resource sector expect further outright declines in their sales volumes. The negative effects of the oil price shock are also increasingly spreading beyond the energy-producing regions and sectors. For example, many businesses across the energy supply chain continue to struggle as they adjust to an environment of weak demand. As well, more firms exposed to slowing demand from their energy-related customers or from households in affected regions feel an indirect, yet often significant, impact on their sales perspectives.

Chart 1: **Firms reported no change in their past sales growth...**

Balance of opinion[a]

Over the past 12 months, did your firm's sales volume increase at a greater, lesser or the same rate as over the previous 12 months?



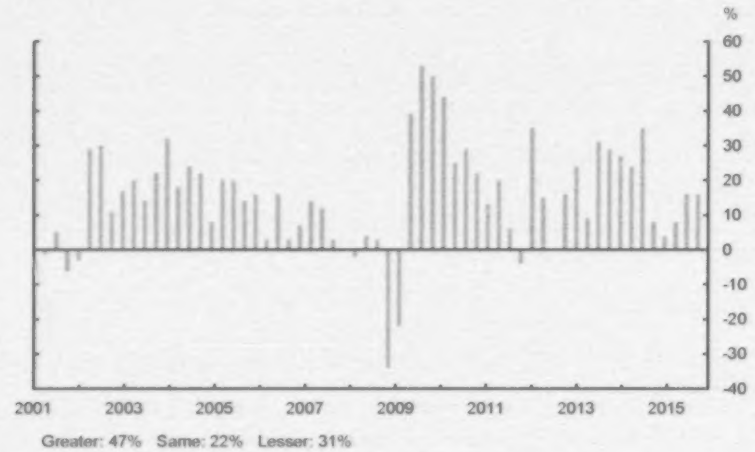
a. Percentage of firms reporting faster growth minus the percentage reporting slower growth

° Indicates a balance of opinion of zero

Chart 2: **...but expect a modest improvement over the next 12 months**

Balance of opinion[a]

Over the next 12 months, is your firm's sales volume expected to increase at a greater, lesser or the same rate as over the past 12 months?



a. Percentage of firms expecting faster growth minus the percentage expecting slower growth

On the upside, firms continue to report that they are benefiting from strengthening foreign demand. Nearly all businesses expect the U.S. economy to grow over the next year, and close to half of them, in particular manufacturing firms, expect this to support their sales. Exporters not linked to commodity production anticipate significantly stronger sales growth than other firms. Indicators of future sales have improved relative to a year ago for firms exposed to foreign markets, whereas order books and sales inquiries from domestic clients have deteriorated. The divergence between foreign and domestic demand was highlighted by firms in most regions.

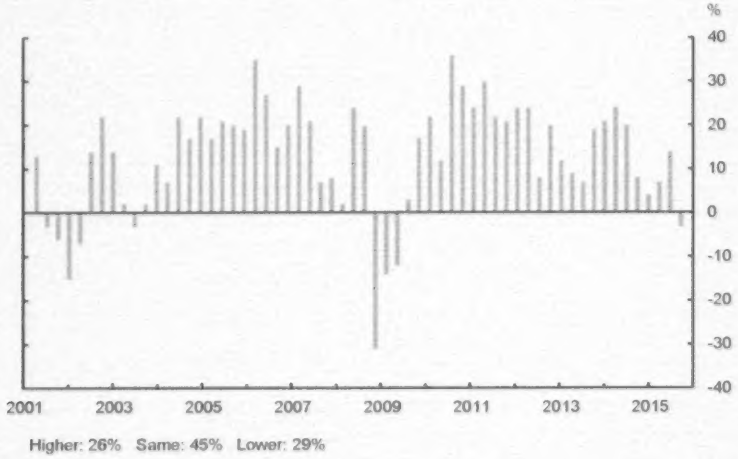
The depreciation of the Canadian dollar continues to affect businesses in various ways. Some firms see their increased competitiveness outside Canada as an opportunity to refocus their sales efforts toward foreign markets or to expand their existing market share abroad. Domestically oriented firms have already benefited from more solid tourism-related activity and expect further gains. However, the majority of firms also face higher costs for imported inputs and investment goods, and some plan to respond by switching from foreign to Canadian suppliers. Finally, as relative domestic production costs decline, a few firms reported plans to move production back to Canada.

The balance of opinion on investment in machinery and equipment fell to its lowest level since the recession (**Chart 3**). At just below zero, the indicator suggests that, on balance, firms expect the level of investment to be about the same over the next 12 months as over the past 12 months. Compared with recent surveys, fewer projects are aimed at expanding production capacity, and many firms are limiting their spending to repairing and replacing existing equipment. The investment outlook for firms in the Prairies deteriorated further, but weakening investment intentions are now also evident in other regions. Businesses most often cited concerns about the strength of domestic demand, uncertainty in the regulatory and tax environment, still-insufficient foreign demand, and low commodity prices as factors restraining their investment. On the upside, exporters outside the commodity supply chain are planning to raise their investment spending to respond to stronger foreign demand.

Chart 3: **Firms expect the level of investment to be about the same as over the past 12 months...**

Balance of opinion[a]

Over the next 12 months, is your firm's investment spending on M&E expected to be higher, lower or the same as over the past 12 months?



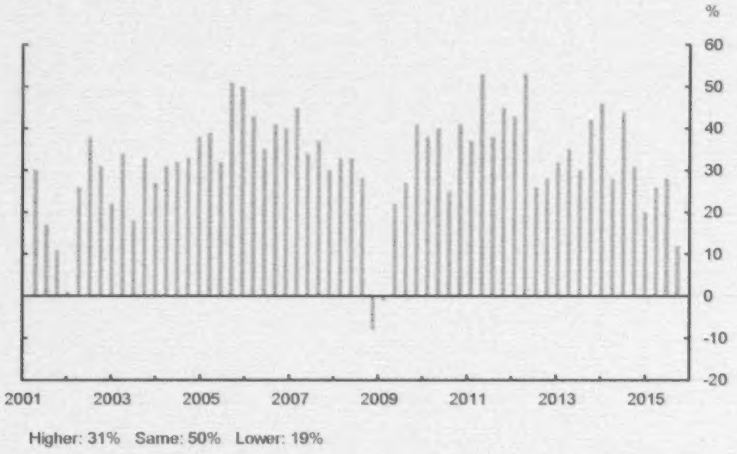
a. Percentage of firms expecting higher investment minus the percentage expecting lower investment

The balance of opinion on employment intentions dropped to its lowest level since 2009 (**Chart 4**). Fewer firms plan to increase their staff over the next 12 months. As well, plans to cut staff are more widespread and are not confined to the commodity-producing sectors and regions. Many firms expecting employment declines quoted the need to cut costs in a challenging environment of persistently low commodity prices, while others also cited efficiency gains. Firms planning to add staff in the next 12 months, often to meet greater demand for their products, are more likely to be based in Eastern and Central Canada.

Chart 4: **...while the balance of opinion on employment intentions dropped, indicating overall weak hiring intentions**

Balance of opinion[a]

Over the next 12 months, is your firm's level of employment expected to be higher, lower or the same as over the past 12 months?



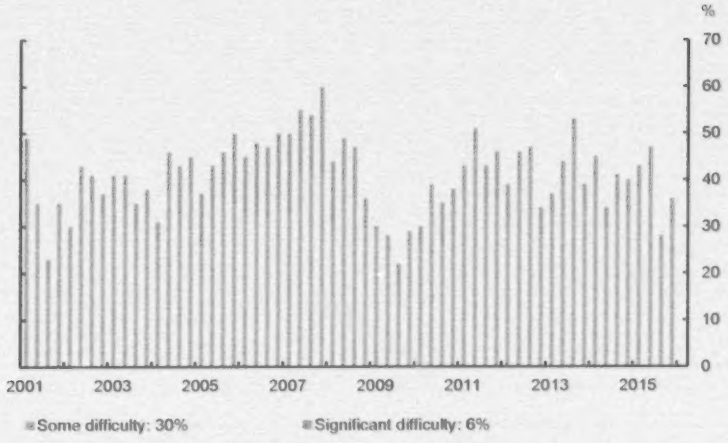
a. Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

The share of firms that would have difficulty meeting an unanticipated increase in demand rose in the winter survey but is still lower than it was in the first half of 2015 and continues to be below the historical average (**Chart 5**), pointing to subdued capacity pressures. Excess capacity was often reported as resulting from weak demand conditions, especially for firms in the Prairies where the indicator now stands at levels seen during the recession. Capacity pressures remain more prevalent among exporters than among domestically oriented firms.

Chart 5: **Capacity pressures continue to be subdued**

How would you rate the current ability of your firm to meet an unexpected increase in demand?

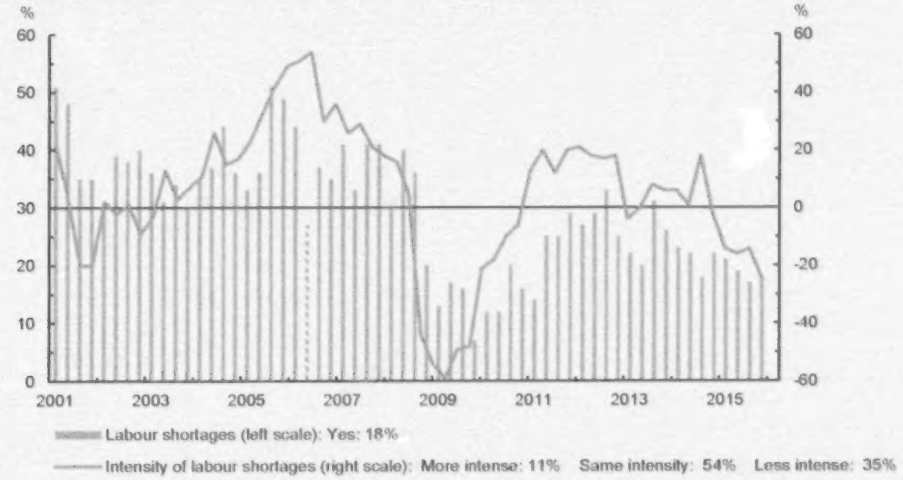


The percentage of firms reporting that labour shortages are restricting their ability to meet demand remains low and is essentially unchanged from the previous survey (**Chart 6**). The balance of opinion on the intensity of labour shortages continues to trend downward, indicating that it has become less difficult to staff positions than it was a year ago, since labour market slack has increased (**Chart 6**). Firms reporting less intense labour shortages cited the downturn in the resource sector and the increased pool of labour available following the slowdown in Alberta. While decreasing pressures were reported most by firms in the Prairies, they were also cited by firms in regions where interprovincial workers are returning from the oil patch.

Chart 6: **The balance of opinion on the intensity of labour shortages continues to trend downward, suggesting increased labour market slack**

Labour shortages: Does your firm face any shortages of labour that restrict your ability to meet demand?

Labour shortage intensity (balance of opinion)[a]: Compared with 12 months ago, are labour shortages generally more intense, less intense or about the same intensity?



a. Percentage of firms reporting more intense labour shortages minus the percentage reporting less intense shortages

The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

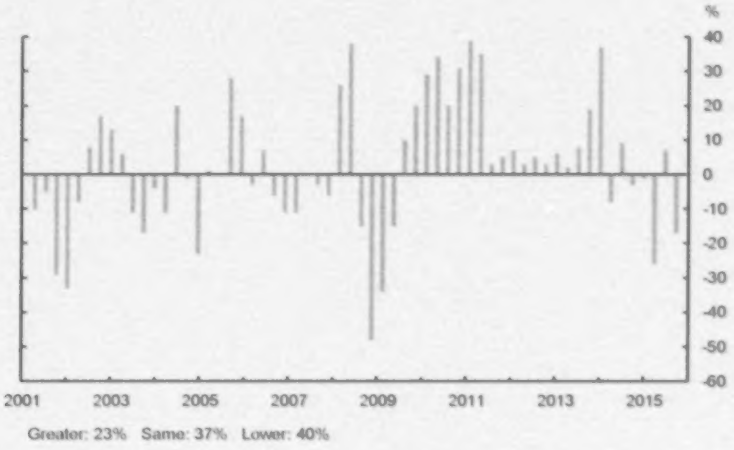
Prices and Inflation

The balance of opinion on input prices again turned negative as pressures on input prices diminished in both the services and the goods sectors (**Chart 7**). Owing to the depreciation of the Canadian dollar in previous quarters, many firms had already seen an increase in the cost of their imported inputs, and most anticipated less upward pressure from the exchange rate over the next 12 months. Some businesses also referred to weak market conditions, partly resulting from the downturn in the energy sector. A number of firms indicated, for example, that it was easier to find subcontractors or to obtain supplier discounts and price concessions. Finally, the weakness in commodity prices continues to be cited as a factor. While some respondents consider that commodity prices are bottoming out, leading to higher expectations for future input prices, others see lower prices as a persistent source of downward pressure on their costs.

Chart 7: **Firms expect input prices to increase at a slower rate over the next 12 months...**

Balance of opinion[a]

Over the next 12 months, are prices of products/services purchased expected to increase at a greater, lesser or the same rate as over the past 12 months?



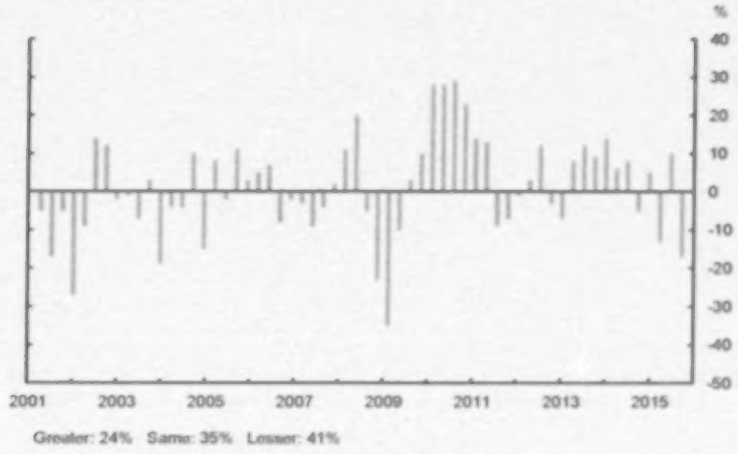
a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases.

On balance, firms also expect their output prices to increase at a slower rate over the next 12 months than over the past 12 months, since the indicator has swung back into negative territory (**Chart 8**). Many firms had already passed on higher prices for their imported inputs to their customers and, at the time of the survey, expected less exchange rate pass-through. Similarly, exporters anticipated fewer positive effects from the exchange rate on their export prices expressed in Canadian dollars. Businesses in several sectors reported that strong competition and sluggish economic activity were continuing to dampen the growth of output prices.

Chart 8: **...and output prices to increase at a slower rate as well**

Balance of opinion[a]

Over the next 12 months, are prices of products/services sold expected to increase at a greater, lesser or the same rate as over the past 12 months?

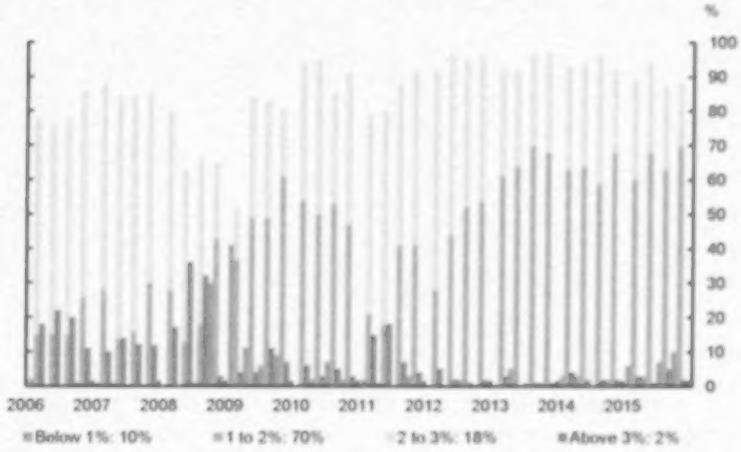


a. Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Inflation expectations declined in the winter survey (**Chart 9**). While the large majority of firms continue to expect CPI inflation to remain within the Bank's 1 to 3 per cent inflation-control range over the next two years, a greater proportion expect inflation to be in the lower half of that range. The lack of momentum in the Canadian economy, together with lower oil prices, was cited as a key driver of firms' inflation expectations. Firms with higher expectations often reported the low Canadian dollar and increased food prices as factors.

Chart 9: **Inflation expectations fell but remain concentrated in the Bank's inflation-control range**

Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?



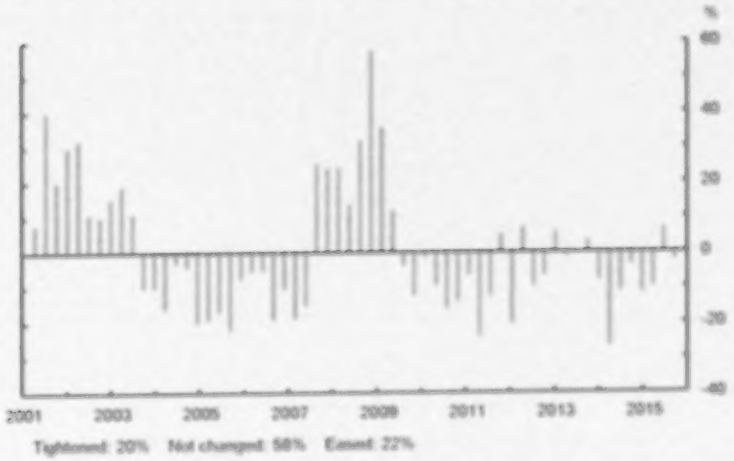
Credit Conditions

Following the net tightening in credit conditions in the autumn survey, the balance of opinion is close to zero, indicating that overall terms and conditions for obtaining financing are largely unchanged in the winter survey (**Chart 10**). Firms exposed to the resource sector or to the broader economic downturn in the Prairies continue to report a tightening in conditions. Some also cited the global market environment, such as the tightening in U.S. monetary conditions, as contributing to the increase in their borrowing costs. Among businesses witnessing an easing in credit conditions, many are tied to export markets and referred to their recent strong performance or to an improvement in their financial health. Overall, most firms continue to characterize credit as easy or relatively easy to obtain.

Chart 10: **Overall, firms reported no change in credit conditions over the past three months**

Balance of opinion[a]

Over the past three months, how have the terms and conditions for obtaining financing changed (compared with the previous three months)?



a. Percentage of firms reporting tightened minus the percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

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